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Financial Services Unit
Financial System Division
The Treasury
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NIBA Submission in response to the Design and Distribution Obligations and Product Intervention Power Proposals Paper

The National Insurance Brokers Association of Australia (**NIBA**) appreciates the opportunity to make this submission in response to the Government's Design and Distribution Obligations and Product Intervention Power Proposals Paper, released in December 2016.

Preliminary Comments – Existing regulatory framework

Table 1 (page 7) of the Proposals Paper outlines the current approach to regulation of financial products throughout the product life cycle.

NIBA is concerned that the Proposals Paper does not discuss two key areas of consumer protection that are unique to insurance, and are highly relevant to the overall thrust of the recommendations and proposals that are being put forward.

As is well known, most products and services are offered on a "buyer beware" basis (caveat emptor – let the buyer beware), and consumer protection mechanisms have been developed to give buyers better understanding of what they are buying, and to require sellers to not act in an unconscionable manner or engage in misleading and deceptive conduct.

However, in relation to insurance contracts, the basis of dealing between the parties (insurer, policyholder, etc) is NOT based on the concept of caveat emptor – it is one of "utmost good faith" (uberrimae fidei – utmost good faith). The doctrine of utmost good faith was first described by Lord Mansfield in the 1766 case of *Carter v Boehm*, and has been a fundamental part of insurance law in common law countries, including Australia, ever since.

The doctrine is now effectively enacted in sections 13 and 14 of the *Insurance Contracts Act 1984*. In addition, ASIC is given specific powers when an insurer has failed to comply with the duty of utmost good faith in the handling or settlement of a claim or potential claim under the contract – section 14A. ASIC may exercise its powers in relation to the general licensing conditions of Part 7.6 of the Corporations Act in relation to the insurer as if the insurer's failure to comply with the duty of the utmost good faith were a failure by the insurer to comply with a financial services law. This allows ASIC to exercise powers of variation, suspension and cancellation of an Australian financial services licence and banning of persons from providing financial services.

ASIC can also bring an action against an insurer, if it is in the public interest to do so, where the insurer has breached the requirements of the Insurance Contracts Act and has caused (or is likely to cause) the insured or a third party beneficiary to suffer damage (s 55A).

There is no mention of these obligations, or the ASIC powers that exist in these laws, in the Proposals Paper. However, they are directly relevant to any discussion relating to the design and distribution of insurance products, and the powers of ASIC in relation to those products.

NIBA understands that ASIC has reservations in relation to the nature, extent and potential effectiveness of its existing powers to investigate and take appropriate action for breach of utmost good faith obligations.

NIBA believes that before new powers are implemented, there needs to be a careful analysis of the existing powers, and the identification of a clearly demonstrated problem or gap, before new powers created. NIBA does not believe the Proposals Paper or ASIC have done this and discusses why further below.

Secondly, Division 1 of Part V of the *Insurance Contracts Act 1984* makes provision for standard forms of cover for most areas of personal insurance, and the *Insurance Contracts Regulations* (whilst in need of updating) go into considerable detail in relation to the nature and content of standard form contracts of insurance.

Hence, there are considerable existing statutory provisions in relation to the design and distribution of contracts of insurance intended to be made available to retail clients. These provisions are not discussed in the Proposals Paper.

Indeed, the *Insurance Contracts Act* itself provides a comprehensive array of consumer protection provisions, and followed a very detailed analysis of the rights and responsibilities of parties to the insurance contract by the Australian Law Reform Commission.

The Act was also reviewed extensively in recent years, with only relatively minor amendments being made in 2013 to keep the legislation in line with developments in society and the insurance markets.

We therefore question the need to apply these proposals to contracts of insurance.

Rather than applying a whole new legislative regime to an area where there is no demonstrated need for “reform”, it would seem preferable to examine the existing product and consumer protection provisions, and ASIC powers, and to make changes only if and when there is a clear and demonstrated need to do so.

The Financial System Inquiry did not appear to consider the specific and comprehensive product and related provisions in the insurance laws of Australia.

In fact, as noted above, this process did occur over a number of years, leading up to the enactment of the *Insurance Contracts Amendment Act 2013*. It is not at all clear that further substantial and substantive reform of the duties and obligations of insurance companies and the distributors of insurance products is warranted.

Proposals Paper QUESTIONS

1. Do you agree with all financial products except for ordinary shares being subject to both the design and distribution obligations and the product intervention power? Are there any financial products where the existing level of consumer protections means they should be excluded from the measures (for example, default (MySuper) or mass-customised (comprehensive income products for retirement) superannuation products)?

2. Do you agree with the design and distribution obligations and the product intervention power only applying to products made available to retail clients? If not, please explain why with relevant examples.

NIBA Response

As noted above, Australia already has a comprehensive legal and legislative regime for insurance law and insurance contracts. This followed a thorough review of insurance law in this country by the Australian Law Reform Commission in the early 1980's. Australia has led the common law world in the development of a modern legal framework for insurance law since the enactment of reforms that followed the ALRC's Reports.

The Proposals Paper sets out an entirely new legal regime relating to the design and distribution of financial products and services. NIBA's view is that if the proposed regime is to be applied to insurance contracts, the current legal and legislative regime needs to be examined and assessed, and the impact of the proposed laws on the current insurance law framework needs to be carefully considered.

The Insurance Contracts Act and associated Regulations already have a range of provisions for stand forms of cover for personal lines insurance policies. Rather than implementing an entirely new legal regime on top of the current provisions, NIBA believes it is timely to carefully review the operation and effectiveness of the standard form of cover provisions. NIBA believes a review of that nature is required, and could produce more effective improvements in consumer protection for retail clients, while at the same time addressing real issues with product disclosure and the level of understanding of what personal lines insurance policies do and do not cover.

We note the Proposals Paper does not propose to apply the design and distribution obligations to products subject to the Credit Act, on the basis that there is a potential overlap with the responsible lending obligations that already apply to credit products. There is a similar potential overlap with the legal regime that applies to insurance contracts.

NIBA supports the proposal that any new obligations apply only to products made available to retail clients. This is consistent with the overall thrust of the current regulatory regime in Chapter 7 of the Corporations Act.

Proposals Paper QUESTIONS

5. Do you agree with defining issuers as the entity that is responsible for the obligations owed under the terms of the facility that is the product? If not, please explain why with relevant examples. Are there any entities that you consider should be excluded from the definition of issuer?

6. Do you agree with defining distributors as entity that arranges for the issue of a product or that:

    (i) advertise a product, publish a statement that is reasonable likely to induce people as retail clients to acquire the product or make available a product disclosure document for a product; and

    (ii) receive a benefit from the issuer of the product for engaging in the conduct referred to in (i) or for the issue of the product arising from that conduct (if the entity is not the issuer).

7. Are there any situations where an entity (other than the issuer) should be included in the definition of distributor if it engages in the conduct in limb (i) but does not receive a benefit from the issuer?

8. Do you agree with excluding personal financial product advisers from the obligations placed on distributors? If not, please explain why with relevant examples. Are there any other entities that you consider should be excluded from the definition of distributor?

9. Do you agree with the obligations applying to both licensed and unlicensed product issuers and distributors? If they do apply to unlicensed issuers and distributors, are there any unlicensed entities that should be excluded from the obligations (for example, entities covered by the regulatory sandbox exemption)? Who should be empowered to grant exemptions and in what circumstances?

NIBA Response

NIBA is in broad agreement with the proposed definitions of issuer and distributor. Our preference is for a broad definition of distributor, in order to achieve a level playing field across the many distribution channels that now exist in the financial services industry.

In relation to the Distributor definition, it currently catches general advice provided whether acting for insurer or customer. Is this the intent as it is unclear? If it is the intent, it is questionable how some of the obligations would practically work where the general advice provider acts for the client.

One area of concern is the case of distributors of financial products who have links to media organisations, and those links are not clearly disclosed to potential consumers.

We are concerned that some so called consumer "campaigns" are in fact commercial sales processes, but the community would not understand that to be the case.

NIBA supports the exclusion of financial product advisers providing personal advice from the obligations to be placed on distributors, as there are important statutory requirements now contained in the Corporations Act requiring those giving personal advice to act in the best interests of the client at all times.

Proposals Paper QUESTIONS

10. Do you agree with the proposal that issuers should identify appropriate target and non-target markets for their products? What factors should issuers have regard to when determining target markets?

11. For insurance products, do you agree the factors requiring consumers in the target market to benefit from the significant features of the product? What do you think are significant features for different product types (for example, general insurance versus life insurance)?

NIBA Response

NIBA is struggling to understand how a requirement of this nature could be created as a legal obligation, and how it would operate in practice, given the very wide variety of risk scenarios in the community, and the wide variation in the ability of consumers to assess and understand the products that are being offered.

For example, XYZ Insurance wishes to offer a product with special features to retail clients. Their market research tells them there are many people in the community who would benefit from the cover to be offered. The problem is that the people who would benefit are spread across the entire community. The insurer would therefore have to market the product broadly, in the hope that those who would benefit from the product will understand this and look at a potential purchase of the product. There are countless scenarios where this could be the case.

No doubt, the insurer would make it clear in its marketing and advertising that the product has certain features that would be of benefit to certain members of the community. Nevertheless, the marketing strategy will be to promote the product to all members of the community, in order to find those who might benefit from the product. It is not clear whether the proposal will allow this to occur.

Related to this is the fact that many insurance products marketed to retail clients are quite generic in nature, especially home, contents, motor and travel policies.

Effectively, the target markets for these products would be the whole community. Does the proposal allow for this to be the case? For example, for a comprehensive motor policy, the target market would be any individual who owns a motor vehicle, and the non-target market would be anyone who does not own a motor vehicle. Needless to say, marketing and advertising would be directed to the whole community. Would this be sufficient to satisfy the proposed requirements?

We note the proposed concept regarding "customers needing to benefit from significant features of the product". Our concern is that everyone's risk management needs are different, and there will be a wide range of circumstances and opinions as to what constitutes significant features of the product that would be of benefit to the individual.

For example, most travel policies have a wide range of benefits that are covered by the policy. Some policies will have enhanced benefits, most likely at an additional cost. Many consumers will be comfortable with the wide range of benefits available in these policies. Other consumers will want to ensure that specific policy items will meet their individual needs and circumstances.

In terms of ability of the target market to understand the key features of the product, where should the line be drawn? Is it the lowest common denominator and if so what are the relevant denominators?

In the circumstances, we are not at all sure whether it is possible to determine what might be significant features of an insurance policy. What would be regarded as significant will undoubtedly vary from consumer to consumer, and from risk to risk.

Overall, we are uncertain that the concept of significant features of the product will be capable of interpretation and application in the real world market place. We believe the concept needs further development and discussion.

Proposals Paper QUESTIONS

12. Do you agree with the proposal that issuers should select distribution channels and marketing approaches for the product that are appropriate for the identified target market? If not, please explain why with relevant examples.

13. Do you agree that issuers must have regard to the customers a distribution channel will reach, the risks associated with a distribution channel, steps to mitigate those risks and the complexity of the product when determining an appropriate target market? Are there any other factors that issuers should have regard to when determining appropriate distribution channels and market approach?

NIBA Response

Credit card companies provide travel insurance without any engagement at all by the credit card holder.

Airline companies offer and sell travel insurance on their web sites, with very limited information about the terms and conditions of the policy being offered (unless the purchaser conducts a deep dive search and reviews the Product Disclosure Statement). There would be no effective engagement by the consumer during the purchasing process.

The major supermarkets offer home, contents, motor and travel insurance to their customers. It is highly unlikely there will be any engagement between the supermarket staff and the customer who might be thinking of buying insurance.

The Federal Government and ASIC are encouraging the use of new forms of technology, new concepts of “insuretech”, and new “sand pit” regulatory approaches to enable and encourage entrepreneurs to offer financial products and services in new and innovative ways.

How will the proposed obligation on issuers operate in these circumstances? If the sales and distribution process is expected to involve genuine engagement with the consumer by people and processes (including web sites) who have “sufficient” knowledge and understanding of the product, will some of the currently significant distribution channels be required to close down?

Recent work by the Insurance Council of Australia has indicated major problems with disclosure requirements on insurers and others, and a major lack of appreciation and understanding of the nature and terms of personal lines insurance policies by retail customers.

The Detailed Proposal 2 matters listed in the box on page 21 of the Proposals Paper could be effectively delivered if general and life insurance policies are only sold through properly accredited and trained insurance brokers, but we presume this is not what is intended by the proposal.

Rather than adding a new layer of complexity, NIBA suggests that a review of the standard cover provisions of the Insurance Contracts Act and Regulations would be a far more effective means of achieving the outcomes that are sought in relation to general insurance policies offered to retail customers with a clearer and stronger obligation on insurers not providing the minimum prescribed cover to advise the customer of this.

By doing this, an agreed base level of minimum cover would be provided which protects the community generally i.e. for those who will never read or understand the documents no matter how well drafted.

Anything else above this is a value add by insurers to promote or differentiate themselves on. We expect this would also make comparison easier.

We do note that frequently, insurance brokers work with industry bodies to develop insurance policy terms and conditions specifically relevant to the particular industry. In those circumstances, the brokers work through the industry body to market those bespoke policies directly to the relevant industry.

We presume this is the type of product design and distribution envisaged by Detailed Proposal 2. While this approach works effectively when the target market can be easily identified, we struggle to understand how an approach of that nature can work when the target customers are part of the broader community, requiring a broad based marketing program to find those potential customers.

The paper notes “Distribution channels whereby consumers can acquire the product without active engagement are also unlikely to be appropriate regardless of the target market. This can involve situations where consumers are ‘opted-in’ to a product by default.”

Does this sign the death warrant for opt out models? Clarity will be essential from ASIC on what it considers to be acceptable or not, as if this is not done properly ASIC can “surprise” industry after the fact at great cost and expense. ASIC should also be required to provide consumer detriment evidence in support of any stated position.

Proposals Paper QUESTIONS

14. Do you agree with the proposal that issuers must periodically review their products to ensure the identified target market and distribution channel continues to be appropriate and advise ASIC if the review identifies that a distributor is selling the product outside of the intended target market?

15. In relation to all the proposed issuer obligations, what level of detail should be prescribed in legislation versus being specified in ASIC guidance?

NIBA Response

NIBA has no difficulties with the proposal that issuers be required to periodically review their product marketing and distribution. We would be very surprised if insurers are not doing this already (or are not already required to).

In relation to the legislative provisions, NIBA firmly believes the legislative requirements should be clear and objective, with ASIC guidance to operate as a supplementary guide only. This is an area where there should be little room for subjective interpretation of legislative requirements on a retrospective basis, as this will risk becoming a disincentive to the development of new and innovative products and services.

There is no set guidance on what an appropriate review timeframe is, leaving it open for challenge as to whether a review has been undertaken with “reasonable frequency”. Should timeframes be prescribed to reduce uncertainty?

Proposals Paper QUESTIONS

16. Do you agree with the proposal that distributors must put in place reasonable controls to ensure that products are distributed in accordance with the issuer’s expectations?

17. To what extent should consumer be able to access a product outside of the identified target market?

18. What protections should there be for consumers who are aware they are outside the target market but choose to access a product regardless?

NIBA Response

As a matter of principle, NIBA does not object to distributors being required to ensure products are distributed in accordance with the issuer’s expectations and requirements. By and large, this would occur at the present time.

NIBA would also support the capacity of consumers being able to access insurance products outside the target market. This assumes there was clear information about the nature and benefits of the product, and a requirement that the consumer has to make a positive decision to purchase the product.

NIBA would prefer any marketing and distribution materials to strongly encourage consumers to seek advice from a licensed insurance broker if they have any questions or concerns in relation to the nature, terms, conditions and cost of an insurance product.

Proposals Paper QUESTIONS

19. Do you agree with the proposal that distributors must comply with reasonable requests from the issuer related to the product review and put in place procedures to monitor the performance of products to support the review? Should an equivalent obligation also be imposed on advised distributors?
20. In relation to all the proposed distributor obligations, what level of detail should be prescribed in legislation versus being specified in ASIC guidance?

NIBA Response

It is common in intermediated insurance that insurers and insurance brokers regularly discuss the marketing and distribution of products, to ascertain how the product is being received in the market and the reactions from clients and brokers to what has been offered.

NIBA is concerned that if this is to become a mandated process, the requirements need to be clearly stated and defined, in order to avoid the potential for substantial additional cost being incurred when undertaking a mandated product review.

NIBA would appreciate the opportunity to discuss and better understand what might be expected of issuers and distributors as part of a mandated product review process.

Our goal in this area is to minimise and where possible reduce “red tape” as far as possible. A cost benefit review of these requirements should be undertaken before the legislative design process is finalised.

As noted above, in relation to the legislative provisions, NIBA firmly believes the legislative requirements should be clear and objective, with ASIC guidance to operate as a supplementary guide only.

Again, this is an area where there should be little room for subjective interpretation of legislative requirements on a retrospective basis, as this will risk becoming a disincentive to the development of new and innovative products and services.

Proposals Paper QUESTIONS

21. Do you agree with the obligations applying 6 months after the reforms receive Royal Assent for products that have not previously been made available to consumers? If not, please explain why with relevant examples.
22. Do you agree with the obligations applying to existing products in the market 2 years after the reforms receive Royal Assent? If not, please explain why with relevant examples and indicate what you consider to be a more appropriate transition period.

NIBA Response

As noted above, these provisions will be entirely new in the context of financial services regulation in Australia. In the area of insurance, there will be a new layer of regulation which will operate over and above the current comprehensive insurance law of this country.

The first thing that will be needed will be for all legislation, regulation and regulatory guidance to be finalised and confirmed.

Once this occurs, issuers and others will need time to assess and understand the new legislative and regulatory environment, and to assess the impact those requirements will have on the design, testing, and proposed distribution of new products.

NIBA believes that a minimum of 1 year will be needed for all of these developments to occur.

Proposals Paper QUESTIONS

23. Do you agree that ASIC should be able to make interventions in relation to the product (or product feature), the types of consumers that can access a product or the circumstances in which a consumer can access the product? If not, please explain why with relevant examples.
24. Are there any other types of interventions ASIC should be able to make (for example, remuneration)?

NIBA Response

NIBA has a serious concern that a number of broad ranging proposals are set out in the Proposals Paper, without any attempt to assess and review the nature and effectiveness of current ASIC powers.

NIBA believes that ASIC has not sufficiently or properly identified where the gaps in its above powers truly exist. A good example is ASIC's Report 498 on Life Insurance Claims handling.

ASIC's statement that the law restricts ASIC's ability to take action for systemic conduct is concerning when it identifies that it has powers to deal with systemic conduct (see paragraphs 59 and 143).

We fail to see how the rights of ASIC under the Insurance Contracts Act for a breach of the duty of utmost good faith and the ASIC Act in relation to misleading or deceptive conduct would not allow it to address systemic issues.

ASIC itself fails to clearly explain why or provide any practical examples of where this has been the case. ASIC should be required to clearly and properly set out the conduct of concern and why its powers in relation to that concern are insufficient. To say that case law regarding the duty of utmost good faith is limited where the basic principles have been clearly set by the High Court and broad enough to suit ASIC's purposes is also concerning.

Section 13 (Breach of the duty of utmost good faith) under the Insurance Contracts Act provides that a contract of insurance is a contract based on the utmost good faith and there is implied in such a contract a provision requiring each party to it to act towards the other party, in respect of any matter arising under or in relation to it, with the utmost good faith.

Section 14 provides that if reliance by a party to a contract of insurance on a provision of the contract would be to fail to act with the utmost good faith, the party may not rely on the provision. This does not limit the operation of section 13. This duty applies to claims conduct.

The High Court in CGU Insurance Limited v AMP Financial Planning Pty Limited [2007] HCA 36 noted that dishonesty alone was not the test and that an insurer should act consistently with commercial standards of decency and fairness, with due regard to the interests of the insured. See also for the most recent detailed analysis of the Duty of Utmost Good Faith and relevant case law - Insurance Law Journal Carter v Boehm: 250th Anniversary Special Issue.

A breach of section 13 gives rise to a damages claim. The measure of damages will be such as that will put the insured in the position they would have been in had the contract been performed – essentially losses flowing naturally from the breach or which the parties ought reasonably to have had in contemplation at the time of making the contract.

A breach of section 14 prevents the insurer from relying on the provision.

The Act does not allow a court to make a finding of liability against the insurer as a punitive sanction for not acting in good faith. A breach of the above provisions is not a criminal offence and does not attract a criminal penalty.

ASIC may as a result of the breach of s13(2) bring an action for breach of the general licensing conditions. ASIC can if it chooses vary a licensee's conditions of its AFSL (s914A of the Corporations Act) to address systemic compliance issues.
This is appropriate as these are the issues that justify action.

These licence conditions may, for example, preclude the AFS licensee from providing certain types of financial services, or may impose different or additional compliance obligations on the licensee, such as requiring the licensee to engage an independent external compliance consultant and provide ASIC with ongoing reports of its progress in remedying previously identified deficiencies in compliance measures.

ASIC must give the licensee an opportunity to appear or be represented at a private hearing before ASIC and to make a submission. There is a right to appeal to the Administrative Appeals Tribunal (AAT). All applications to the AAT must be made in writing and within 28 days of receiving ASIC's decision.

ASIC fails to explain that it's general approach in any identified issue of concern is to allege a breach of the law and seek remediation, failing which it will implement proceedings of some sort, whether for damages or penalties. The incentive for an insurer to manage the issue with ASIC is the same whether it is a penalty or damages route, or in the case of misleading or deceptive conduct, damages, penalties, injunctions and other court orders.

Misleading or deceptive conduct would typically pick up matters not covered by the duty of utmost good faith and apply in addition in most cases. A breach of s12DA of the ASIC Act allows ASIC to obtain injunctions and seek civil pecuniary penalties amongst other things – See Sub Division E – Enforcement and Remedies

As a final example, ASIC raises in its report the concern regarding Incentives for claims handling staff and management. If claims staff were acting improperly having regard to their incentives, this would in our view be a breach of the insurer's duty of utmost good faith. Is ASIC of a contrary view and if so why?

ASIC should be required to justify and provide examples of where it has been unable to rely on its powers to achieve change or take action for systemic issues that breach the law.

It is our view that if it has not done so, it has not engaged in the proper exercise of its powers, rather than not having sufficient powers as it alleges.

In addition to current ASIC powers, there are a wide variety of current other consumer protection provisions such as in the Australian Consumer Law, the ASIC Act, and the Privacy Act, etc.

We note that the directors of Storm Financial were found to have individually breached the requirements of the Corporations Act under provisions in place before the Act was amended by the Future of Financial Advice package, and more recent amendments.

NIBA is also concerned that the proposals will give ASIC very wide, quite subjective powers to intervene in financial markets, where there may or may not have been a breach of the Corporations Act or other relevant law.

We would like to firmly submit that before any further steps are taken in relation to ASIC powers of intervention, a thorough assessment of current powers should be undertaken, and proposals for reform should be based on clearly documented assessments of inadequacy of those provisions.

Secondly, NIBA firmly submits that the legal obligations on manufacturers and distributors of financial products and services should be clear, objective, easily understood and able to be readily adopted and applied by market participants. ASIC should have the power to intervene when there have been clear breaches of those provisions.

At the present time, it is not possible to provide a substantive commentary on the Proposals Paper section on ASIC intervention powers, as the description of the proposed powers are very general and are capable of wide interpretation, when legal clarity and certainty will be essential.

We recommend a further, detailed discussion paper which addresses specific areas of limitation or weakness in ASIC's powers, and puts forward clear and specific real examples of where ASIC has had issues as well as proposals to deal with those areas of limited capacity or weakness.

Proposals Paper QUESTIONS

33. What enforcement arrangement should apply in relation to a breach of the design and distribution obligations of the requirements in an intervention?
34. What consumer rights and redress avenues should apply in relation to a breach of the design and distribution obligations or the requirements of an intervention?

NIBA Response

As noted above, ASIC currently has a wide variety of enforcement powers as part of its "regulatory toolkit". The Government is currently reviewing ASIC's enforcement powers.

NIBA believes that ASIC's powers of enforcement should be consistent with those powers it currently has available to it, unless there has been a clear demonstration that those powers are ineffective in a material manner.

Similarly, consumers currently have substantial rights of compensation and redress, and NIBA believes those rights should be maintained. NIBA is happy to consider and discuss any areas where current consumer rights of redress and protections are thought to be inadequate.

NIBA would prefer to respond to a further discussion paper which clearly sets out the proposed changes to ASIC's powers of enforcement, and which clearly states the proposed avenues for consumer rights and redress.

Conclusion

NIBA would be pleased to have the opportunity to discuss these matters in further detail, and to explain our concerns regarding the increasing complexity of legislative and regulatory intervention in relation to life and general insurance.

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